remedy was to remand, rather than to vacate, the rule[1079] We now consider whether the current rule can be justified as necessary to promote competition, diversity or localism

2. The Current National TV Ownership Rule Cannot Be Justified

507. Under Section 202(h), we must evaluate whether the national TV ownership rule continues to be "necessary in the public interest as the result of competition."[1080] To make this determination, we consider whether the rule serves the public interest by furthering our policy goals of competition, localism, or diversity. The evidence demonstrates that a national TV ownership limit is necessary to promote localism by preserving the bargaining power of affiliates and ensuring their ability to select programming responsive to tastes and needs of their local communities. However, the evidence also demonstrates that the current cap of 35% is not necessary to preserve that balance.

a. Competition

508 In analyzing whether the current rule is necessary to protect competition, we focus on whether and to what extent market power exists in any relevant market, and what effect the rule has on the existence and exercise of this market power. In the 1984 decision to eliminate the national ownership cap, the Commission limited its competition analysis to the national television advertising market.[1081] In this decision, we expand our competition review to include the national program acquisition market. The national cap affects economic concentration in national markets by limiting the size of group owners of television stations, but does not affect concentration in the local video delivery market, and thus does not raise competition concerns that were discussed in the local ownership rule sections above. The national cap limits the ability of group owners to purchase television stations in individual local markets. The effect of this ownership restriction on station performance in the video delivery market is discussed in the localism section below

509. Based on our analysis of the relevant markets, we find that the current rule is not necessary to maintain competition in the three economic markets we examine As the record before us indicates, the media marketplace is undergoing unprecedented change. Broadcast stations are subject to competition from cable and DBS,[1082] and they face increased competition for viewers, advertising revenues, station network affiliations, and programming.[1083] We conclude that the 35% cap is no longer necessary to protect competition in the media marketplace and unnecessarily constrains the organization of, and investment in, free, over-the-air (*i e.*, non-subscription) broadcast television.

510. *Broadcast competition framework.* The evolution of non-price competition in television has implications for the economic organization of broadcast television networks. Higher channel capacity cable systems and the growth in the number of cable networks, together with the programming options

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[1079] *Id* at 1048-49

[1080] 1996 Act, § 202(h)

[1081] *1984 Multiple Ownership Report and Order*, 100 F C C.2d at 39-40 ¶¶ 67-71.

[1082] *See* Modern Media Marketplace, *supra* Section IV.

[1083] Paxson notes that broadcasters face competition today from "a dizzying array of diverse and high quality entertainment and news choices." Paxson Comments at 11 offered by DBS, have intensified the competitive pressure on broadcast television networks to slow the erosion of viewer market share and to build strong network brand identity reflecting program focus, quality and reputation [1084]

511. Two broadcast television network organizational changes, which are viewed as responses to the growth in viewer options, are noteworthy, namely, (1) the extensive backward integration into program supply, and (2) the desire to increase the extent of forward vertical integration through ownership of additional local television stations. Transaction cost economics suggests that such organizational integration induced by increased rivalry within the media industry may improve economic efficiency

512 Transaction cost economics adopts a contractual approach in understanding the economic organization of firms.[1085] The transaction—the exchange of goods or services for money or other goods between parties—is the focal point of economic analysis. Determining the governance structure that minimizes the economic cost of effectuating a particular type of transaction is a central objective of a transaction cost analysis Transaction cost economics identifies three, discrete governance structures, namely, (1) the market; (2) hybrid contracting; and (3) hierarchy, where transactions are placed under unified ownership in a firm subject to administrative controls and management.[1086] Whether it is economically efficient (cost minimizing) to effectuate exchange using market contracting or through hierarchy (vertical integration) depends on certain behavioral assumptions, and key attributes of any given transaction. [1087]

[1084] Reputation may constitute a mobility barrier that helps deflect continuing market share erosion in the mass audience strategic group An empirical study of the relationship between reputation and strategic groups in the insurance industry is provided by T D Ferguson, D L Deephouse, and W L Ferguson, *Do Strategic Groups Differ in Reputation?*, 21 STRATEGIC MGMT J. 1195, 1195-1214 (2000).

[1085] Oliver E Williamson, THE MECHANISMS OF GOVERNANCE 54 (Oxford Univ. Press 1999).

[1086] *Id* at 378

[1087] From a transaction cost perspective, transactions differ one from another in three important dimensions, namely, (1) the frequency of a given type of transaction; (2) the degree and type of uncertainty implied by the transaction, and (3) the condition of asset specificity. While all three dimensions are important in determining the least costly governance structure for organizing transactions, the condition of asset specificity is especially important Asset specificity refers to the degree that an asset can be redeployed to alternative uses and by alternative users without a substantial loss in productive value. Asset specificity is similar to the concept of *sunk cost* as found in the literature on the theory of contestable markets and recent game-theoretic models of industry structure and performance. Asset specificity is a somewhat broader concept than sunk cost, however, and its full significance is apparent only within the context of incomplete contracting Transaction cost economics recognize that asset specificity can take many different forms including, but not limited to, site specificity; physical asset specificity, human asset specificity derived from learning-by-doing; and dedicated assets, representing discrete investments in general purpose plant or facilities for meeting the demand for output for a specific customer *See* Williamson, *supra* note 1088 at 50

513 In general, ordinary market contracting is an efficient governance structure for transactions supported by general purpose assets not dedicated to the specific output demand of a given customer. As asset specificity deepens, market contracting as a governance structure gives way to either hybrid structures or hierarchy (vertical integration) as the least costly to organize transactions.[1088] The pervasiveness of asset specificity in the program production industry suggests that complex contracts between broadcast television networks and program suppliers may not be the least costly governance structure for effectuating transactions.

514. Broadcast television networks have a single, strategic focus, namely, the maximization of the number of television viewers that are attracted to mass audience and niche audience programming.[1089] This strategic focus is crucial to broadcast television networks, since the sale of audiences to national advertisers provides their only stream of revenue from broadcast operations in contrast to cable networks which may receive both advertiser and subscriber revenue.[1090] By contrast, local broadcast television stations pursue a more complex business strategy as licensed broadcast facilities. First, the local station seeks to maximize the size of its audience it attracts within its local television market. If the local station is a network affiliate, then the local station will promote the network's program schedule together with syndicated programming the station may acquire to help fill out its daily program schedule. Second, the local station will also promote its own locally-produced programming, such as news and public affairs programming, that it believes is responsive to issues or viewer preferences in the communities served by the station Station management may vary the allocation of time devoted to any particular type of programming, including network programming, to respond to emerging preferences or news events in the communities located in its local television market.

515. As the networks have lost viewer market share over the last decade in response to the growth in cable and DBS, the traditional contractual relationship between a television network and a local station affiliate may be a less efficient governance structure. From a transaction cost perspective, television networks view their massive sunk investments in network programming as increasingly risky assets as non-broadcast program options proliferate.

516. With respect to contractual safeguards, the networks have attempted to negotiate substantial penalties for failure to clear a full schedule of network programming. With respect to changes in governance structure, the broadcast television networks have argued for elimination of the national

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1088 The condition of asset specificity, if pervasive, poses substantial contracting hazards such that ordinary market exchange as encountered in competitive markets may be impaired or even effectively blocked In other words, the transaction cost of operating a market mechanism as a governance structure in the presence of deep asset specificity may be so high that a market will simply fail Thus, market failure may be attributable not only to various externalities but to excessive transaction costs as well This insight is attributed to Kenneth Arrow, according to Williamson *See* Oliver E. Williamson, THE ECONOMIC INSTITUTIONS OF CAPITALISM 19 n.8 (1985).

1089 Roughly speaking, broadcast television revenues tend to be proportional to audience size. Assuming that marginal operating cost is small relative to the fixed cost of operating a broadcast television network and generally invariant with respect to changes in audience size, then maximizing audience size is roughly equivalent to maximizing profit

1090 In most cases, broadcast television networks today are organizational units of larger media enterprises, *e.g.*, ABC is one of numerous business units operated by the Disney corporation, that have numerous revenue streams Corporate management ordinarily expects, however, that each business unit will recover its unit-specific fixed and variable costs, contribute to the cost of shared corporate services and functions, and earn unit-specific profit.

ownership cap, which would permit the networks to substitute hierarchy (vertical integration) for the current contractual relationship with independently-owned station affiliates. Presumably, the networks believe, consistent with transaction cost logic, that conflicts in strategic focus between stations and the network respecting programming decisions can be resolved more efficiently, *i e* , at minimal transaction cost, if hierarchy, *i e* , forward vertical integration, replaces market contracting as the governance structure.

517 Thus, our transaction cost analysis suggests that our national ownership cap probably restricts the full transition to the least costly way for organizing transactions between television networks and local television stations, *i e* , forward vertical integration, *assuming* that realization of a network's singular strategic focus on mass or niche audience size is the preferred policy objective. If, however, locally produced programming and ultimate program selection authority are a higher policy priority, then our transaction cost economic framework identifies the relevant policy trade-off, namely, the incremental social benefit of local programming viewed as a component of our localism policy goal versus the increased social and private costs of inefficient contracting.

518. *Program Production and Acquisition Market.* Competition in the program production and acquisition market is important because networks and owners of individual television stations compete with each other, as well as with cable television networks, to acquire programming that will continue to attract viewers to their channels Although television station owners as a group are relatively significant purchasers of programming, we have no evidence that they exercise market power in the program production market.[1091]

519. In considering the effect of the national television cap on competition in the program acquisition market, we first must identify the market participants. The broadcast networks contend that the following categories of firms compete in the program acquisition market: broadcast television networks, individual television stations (and group owners thereof), non-broadcast program networks (*i.e.* cable networks), syndicators, pay-per-view systems, VHS and DVD rental stores.[1092] NASA counters that major broadcast networks are a discrete sub-market, or "strategic group," within the program purchasing market.[1093] We generally agree with the networks' definition of the relevant market participants, although we exclude video sales and rental stores. We disagree with the networks' contention that such outlets are clearly a substitute for the delivered video programming of broadcast channels and cable channels. Those channels are the most conventional form of television viewing that can be substituted among by viewers almost instantly It is possible to analyze the impact on the program acquisition market of relaxing the national television ownership cap by examining company expenditure shares. The following describes estimates of expenditure shares and calculation of a hypothetical HHI. The analysis assumes that the buyers in this market are broadcast networks, broadcast stations, and cable networks [1094] OPP Working Paper 37 (Table 32) provides estimates for the year 2000 of programming expenditures by the Big Four

[1091] *See* Miscellaneous Requests, Independent Producers *infra* Section VIII(D)

[1092] Fox Comments, Economic Study E

[1093] NAB/NASA Reply Comments at 57

[1094] Our market definition includes pay cable networks as well as pay-per-view networks, but in the absence of data, they are excluded from this analysis.

commercial networks and by television stations.[1095]

520 The table below provides program expenditure data for the year 2000 for the Big Four broadcast networks in column 2 and for eight firms that own cable networks in column 4 The eight firms include the top four broadcast networks, the two biggest cable network owners that do not own television stations, and the two companies with the biggest cable network shares that also own television stations. There is also a residual category that includes all other cable network expenditures as "Other."

521 Column 3 includes some hypothetical broadcast station owner shares. We do not know exactly how station expenditures are divided up among companies that own television stations. The numbers in this column represent a "worst case scenario" of what could happen if the national television cap were eliminated. In 2000 there were 1248 commercial television stations on the air. We know that the major commercial networks each reach virtually 100% of US television households and that each network has roughly 200 affiliated stations.[1096] If stations were distributed evenly across markets, then there would be room for six television station companies each reaching all US television households.

522. However, stations are not evenly distributed across markets. There are 50 Nielsen DMAs with fewer than four commercial stations, but they account for only 4.6% of US television households, so, from the point of view of station programming expenditures, it is reasonable to assume that each of the top four broadcast networks could achieve 100% coverage of US television households. However, there are 120 markets with fewer than six commercial television stations, and those markets account for 19.7% of US television households. So it is reasonable to assume that two additional station groups could grow to 80% coverage This analysis assumes that television station program expenditures are divided among six firms: the four networks with 100% coverage, and Cox and Hearst, each with 80% coverage. We assume that expenditures are proportionate to coverage. The resulting expenditure estimates are in column 3 These estimates reflect a level of concentration that is higher than the true level There are 63 markets with more than six commercial stations in them. Adding up the excess over six stations in each market yields a total of 259 stations We know that a single company can own multiple stations in the same market, but it is likely that even with more companies owning two stations in a market that there will still be more than six station owners in some markets

523. Column 5 contains hypothetical total programming expenditures for the eight firms, aggregating across broadcast network, broadcast station, and cable network categories, and using the hypothetical consolidated television station ownership pattern described above. Column 6 shows market shares and column 7 implements the HHI calculation by squaring and summing the market shares. The resulting "worst case" HHI of 1535 is in the moderately concentrated range. Even with the highly unrealistic assumption of a 100% national reach by four companies, and an 80% reach by two companies,

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[1095] The network figure is based on gross advertising revenue data from the Television Bureau of Advertising, FCC data on net advertising as a percentage of gross, and a trade press estimate of network programming expenditures as a percentage of net advertising revenues This yields a total figure for the top four networks rather than estimates for each network This analysis assumes that the networks each spend the same amount, which we believe is a reasonable approximation although Fox probably spends less than the other three. The television station estimate is based on data in the NAB Television Financial Report. The cable programming network figures come from Kagan World Media publications, ECONOMICS OF BASIC CABLE NETWORKS (2002) at 432-433 and CABLE PROGRAM INVESTOR (Jan. 17, 2003) at 6. Data are available for 65 basic cable networks and for the HBO, Showtime, and Starz premium channels.

[1096] There are 210 Nielsen DMA markets, and in a few cases a network has more than one affiliate per market.

these levels of market share provide us with no basis to conclude that the current 35% cap on national television ownership is needed to protect competition in the program acquisition market.

Hypothetical HHI for Program Acquisition (data are year 2000 in millions of $)

	Broadcast Network	Broadcast Station	Cable Network	Total	Market Share	Market Share Squared
Cox	0	969.5	139.4	1108.9	4.37	19.13502
Hearst	0	969.5	530	1499.5	5.92	34.98944
ABC	2581.75	1212	1276.7	5070.45	20.00	400.071
Fox	2581.75	1212	521.8	4315.55	17.02	289.812
GE	2581.75	1212	300	4093.75	16.15	260.7875
Viacom	2581.75	1212	1466.4	5260.15	20.75	430.5666
Time Warner	0	0	2162.9	2162.9	8.53	72.79758
Liberty Media	0	0	786.3	786.3	3.10	9.621009
Other	0	0	1052.5	1052.5	4.15	17.23806
Total	10327	6787	8236	25350	100.00	1535.018

524. *National Advertising Market* The Commission's focus is not on advertisers, but on the ability of broadcasters to compete for advertising revenues. Broadcast networks compete for advertising dollars by creating national audiences for their programming. If the networks cannot generate national audiences, their ability to compete for advertising revenues will decline, thereby diminishing their ability to invest in innovative programming. As a result, viewers will experience a decrease in programming choices and quality.

525. In its 1984 decision, the Commission determined that elimination of the national cap would not harm competition in the national advertising market.[1097] The Commission found that the number of firms in the market would ensure continued vigorous competition in that market. In the *Notice*, we sought information on whether our conclusion in 1984 continues to be valid. To analyze competition in this market, we sought comment on the firms that compete in the national television advertising market, including the extent to which national spot advertisements and/or syndicated programming are fungible with network television advertising from the perspective of advertisers.[1098] The national television advertising market brings together those advertisers wishing to reach a national audience with television networks that provide national exposure. Broadcast television networks are the leading suppliers of national television advertising.

526 NAB/NASA claims the record demonstrates that national spot advertising is competitive

[1097] *1984 Multiple Ownership Report and Order*, 100 F.C.C.2d at 52 ¶102.

[1098] National spot advertising time is sold by stations to national advertisers, which aggregate national or regional coverage by purchasing advertising spots from stations in multiple markets. Syndication refers to advertisements sold in syndicated programs *See* OPP Working Paper 37 at 11.

with national advertising.[1099] National advertisers can purchase advertising on a collection of local television stations that can approximate a national advertisement on a single network Local television stations sell national spot advertising through advertising agencies, which aggregate the available advertising on local stations for national spot buyers. NAB/NASA contends that when demand for national advertising on a particular network show exceeds the available supply of national network advertising time, advertisers turn to the national spot advertising market to reach viewers.[1100] Television stations rely in part on the national spot advertising market for a portion of their advertising revenue. NAB/NASA argues that if the ownership cap is raised, the broadcast networks will increase their ownership of television stations and decrease the national spot availabilities to such an extent that the viability of the national spot market will be impaired[1101] Specifically, NAB/NASA contends that a network-owned station will not compete against its network for national (spot) advertising revenue. The result, according to NAB/NASA, is that competition in the national advertising market will be diminished by the decreased viability of national spot advertising as a substitute for network advertising. NAB/NASA asserts that the resulting loss of revenue to local stations will harm their ability to compete with other delivered video providers.[1102]

527. *Discussion* We agree that a strong national spot advertisement market is an important component of the financial stability and competitiveness of television station owners. We find, however, that the increase in the cap from 25% to 35% has not harmed national spot advertising revenues. Our analysis of advertising revenue data indicates that despite increases in ownership of stations by CBS, NBC and Fox since 1996, there has been no diminution in the national spot advertising market that can be reliably associated with an increase in network station ownership. With the exception of 2001, national spot advertising has experienced a relatively consistent growth.[1103]

528. Although we agree with NAB/NASA that network-owned stations have less incentive to compete directly with an affiliated broadcast network in the national advertising markets, we cannot agree that such competition in fact would not occur. If national advertisers are willing to pay a higher per-spot price to network-owned stations than are local advertisers, network-owned stations might well accept the higher priced advertising. Thus, the profit-maximizing behavior of the network-owned stations might well serve as a substitute for national advertisers seeking to purchase national spot advertising Such a response by network-owned stations would maintain the viability of national spot advertising as an option

[1099] *See* B.D McCullough & Tracy Waldon, *The Substitutability of Network and National Spot Television Advertising*, 37 Q J BUS. & ECON 3 (Spring 1998) (*"Network Substitutability"*) (concluding that the estimated elasticities suggest that the network and national spot advertisements have been, and continue to be, good substitutes in the aggregate). *But see* Silk, Klein, and Berndt, *supra* note 522 at 323-48 (eight national media classes are not viewed as substitutes by national advertisers)

[1100] NAB/NASA Comments at 59

[1101] *Id* at 61-62.

[1102] *Id*

[1103] Since 1996, the broadcast networks have increased the number of owned and operated stations, yet the national spot advertising volume has risen from $9.1 billion in 1995 to $12.2 billion in 2000. From 1990-1994, the compound annual growth rate (CAGR) in the national spot advertising market was approximately 4 9% as compared to the CAGR for 1995-2000 of approximately 6.1%. *See* OPP Working Paper 37 at 13. *See also* Richard Billotti, *The Case for Moderate Growth in TV Advertising*, EQUITY RESEARCH (Jan 3, 2003).

for national advertising regardless of the level of the national television cap. Moreover, even if the top four networks were to acquire additional local stations and declined to use the national spot advertising availabilities to compete with their own network's advertising availabilities, there is every reason to think the network-owned stations would seek to take national advertising dollars away from *other* broadcast networks. That is, even if an NBC-owned station sought not to compete with the NBC network for advertising dollars, the NBC-owned stations have incentives to compete in the national spot market for advertising dollars that might otherwise go to the CBS, ABC, and Fox networks. Consequently, we cannot say that the national cap is necessary to protect competition in the national advertising market.

529 *Innovation* In the *Notice*, we asked whether the national ownership cap promotes or hinders innovation in the media marketplace.[1104] Affiliates argue that non-network owners encourage innovation because affiliates provide a competitive outlet for innovative programming. NAB/NASA provides nine examples of innovation by non-network group owners, such as satellite newsgathering encouraged by affiliates to improve upon network-delivered news; the development of the local newsmagazine format; all-news cable channels developed for cable carriage; digital TV experiments such as the multicasting by several affiliates of the NCAA tournament; the delivery of local news in HDTV format; and the creation of iBlast, a joint venture between affiliates and an outside firm to develop new uses for digital spectrum.[1105]

530. Taking an opposing view, Fox contends that the cap limits networks' investment in innovative programming by "inhibiting economic efficiencies" that come with a larger number of owned and operated stations. As evidence, Fox refers to a study by Michael Katz which concluded that, by inhibiting the potential economic efficiencies available to group owners, the rule artificially raises the cost of operating television stations and limits the return that group owners can realize on their programming investments.[1106] Katz argues that the rule drives group owners to direct more of their resources away from free television and toward alternative means of distributing programming content, such as subscription-based cable channels.[1107]

531 *Discussion* The current national ownership cap appears to encourage innovation in broadcast television by preserving a number of separately-owned station groups, including non-network owned station groups. The current number of station group owners has led to innovation in ways that benefit the public. Those developments include the creation of local all-news channels in partnership with local cable companies, the implementation of program formats such as local newsmagazines, and, importantly, experimentation with the spectrum allocated to local broadcasters for digital television [1108]

532. The transition to digital television represents a critical evolutionary step in broadcast television. We are committed to ensuring the rapid completion of that transition in a way that delivers the greatest possible benefits to the viewing public. We believe that the broadcast industry is more likely to rapidly address the technical and marketplace issues associated with digital television if there are a variety

[1104] *Notice*, 17 FCC Rcd at 18549-50 ¶ 146

[1105] *See* NAB/NASA Reply Comments at 23-27.

[1106] Fox Comments at 43; Katz, *supra* note 66

[1107] Katz, *supra* note 66 at 48-51.

[1108] NAB/NASA Reply Comments at 57-58

of group owners exploring ways to use the spectrum. The record shows that non-network owners of television stations are actively exploring different ways of using digital spectrum. It is also important to have group owners with potentially different economic incentives in this area examining transition mechanisms to digital television Because of networks' ongoing investment in programming, it is possible that networks may have incentives to use digital spectrum differently from affiliates. The Fox television network, for instance, has indicated its interest in using the spectrum of its owned stations as well as its affiliates for future services.[1109] Therefore, we conclude that a national television cap is necessary to preserve a number of separately-owned television station groups, including non-network groups, that will increase the types of digital transition experiments and ultimately facilitate a rapid and efficient transition to digital broadcast television.

b. Diversity

533. The *1984 Multiple Ownership Report and Order* concluded that the local community is the relevant market for evaluating viewpoint diversity and that, therefore, the national TV ownership rule is not needed to promote viewpoint diversity.[1110] The *1984 Multiple Ownership Report and Order* also stated that the national market is not relevant for evaluating viewpoint diversity, but even if it were, the proliferation of media outlets renders the national ownership restrictions unnecessary.[1111] In the *1998 Biennial Review Report*, the Commission did not analyze the rule's effects on viewpoint diversity and merely stated, without evidentiary support, that the rule promotes diversity of programming.[1112] In remanding the national TV ownership rule, the court in *Fox Television* found that the Commission had failed to support its 1998 conclusion that the rule is necessary to strengthen affiliates' bargaining power and had neglected to address its 1984 determination that the national market is not the relevant geographic area to consider when evaluating diversity.[1113] We address the issue of affiliates' bargaining power in the following section and address diversity here.

534. In the *Notice*, we observed that the national TV ownership rule does not appear to be relevant to the goal of promoting viewpoint diversity because people gather news and information from sources available in their local market and that the relevant geographic market for viewpoint sources is local, not national.[1114] We also noted that the viewpoints aired by television stations in one city do not seem to have a meaningful impact on the viewpoints available in other cities.[1115] Commenters do not provide evidence that persuades us to alter those views, and we affirm our 1984 conclusion that the national TV ownership rule is not necessary to promote diversity.

[1109] NAB/NASA Comments at 42

[1110] *1984 Multiple Ownership Report and Order*, 100 F C C.2d at 27 ¶¶ 31-32

[1111] *Id* at 27-31 ¶¶ 33-43

[1112] *1998 Biennial Review Report*, 15 FCC Rcd at 11075 ¶ 30.

[1113] *Fox Television*, 280 F 3d at 1042-43.

[1114] *Notice*, 17 FCC Rcd at 18546 ¶136

[1115] *Id*

535. *Discussion* We conclude that the national television cap is not necessary to promote viewpoint diversity. Americans use media outlets available in their local communities as sources of information The national television cap, by contrast, ensures a larger total number of station owners *nationwide,* but it has no meaningful impact on viewpoint diversity within local markets.[1116] Therefore, we affirm our 1984 decision that the national television ownership limit is not necessary to promote viewpoint diversity.[1117] We also affirm our decision that the market for viewpoint diversity is local, not national And we reiterate our 1984 statement that even if the national market were the relevant area to consider, the proliferation of media outlets nationwide renders the current rule unnecessary.[1118]

536 Although proponents of the current rule assert that the increased uniformity imposed by the networks' national distribution agenda limits the number of viewpoints available to the public,[1119] we do not find convincing evidence in the record indicating that raising the current national TV ownership limit would harm viewpoint diversity. Professors Schwartz and Vincent assert that maintaining a diversity of ownership across local markets is beneficial because viewers may become aware of investigative news stories presented by stations in other markets, particularly those of strong stations.[1120] NAB/NASA argues that "this type of cross-fertilization is less likely to occur in the absence of the national TV ownership rule"[1121] For this cross-fertilization to be a plausible scenario, the following minimum conditions must occur: (1) the national cap prevents a station from being acquired by a broadcast network, (2) the non-acquired station produces content that by some measure is meaningfully different (and significant from a viewpoint perspective) from what the network-owned station would have aired; and (3) the airing of that different content becomes known to consumers in other localities. The national cap cannot be justified by reference to such a hypothetical scenario as this.

[1116] It is possible, of course, that the replacement of one station owner by another could in fact reduce the number of independently-owned television stations in that market. If the acquiring firm already owned one station in that market and the seller was selling its only station in that market, there would be one less independently-owned station in that market The impact of such a transaction on viewpoint diversity would be accounted for under the diversity component of our local rules

[1117] *See* Fox Comments at 34-35. We are not persuaded by claims to the contrary *See* UCC Comments at 49-50, 53-54, Cox Comments at 65, IPI Comments at 63; AFTRA Comments at ¶ 123; CCC Comments at 22.

[1118] *1984 Multiple Ownership Report and Order*, 100 F.C C.2d at 25, 27 ¶¶ 24, 33. *See also* Modern Media Marketplace, *supra* Section IV; Fox Comments at 10-26, Paxson Comments at 9-11; Letter from John C. Quale, Counsel for Fox, to Marlene Dortch, Secretary, FCC (May 2, 2003) ("Fox May 2, 2003 Ex Parte"), Attachment A at 18. *But see* Cox Reply Comments at 18-22 (growth of other media outlets does not negate the need for the 35% cap)

[1119] NAB/NASA Comments at 12; NAB/NASA Reply Comments at 6, Cox Comments at 26-31.

[1120] NAB/NASA Comments, Attachment 1, Marius Schwartz & Daniel R. Vincent, *The Television National Ownership Cap and Localism* ("NAB/NASA Comments, Schwartz/Vincent Paper") at 12-13 *See also* NAB/NASA Comments at 12, 69-70, Cox Reply Comments at 12-13

[1121] NAB/NASA Comments at 69.

537 Commenters discussing types of diversity other than viewpoint diversity do not provide an evidentiary basis for retaining the current cap.[1122] The *1998 Biennial Review Report* stated that "[i]ndependent ownership of stations also increases the diversity of programming by providing an outlet for non-network programming "[1123] In this *Report and Order*, however, we have concluded that we can and should rely on the marketplace, rather than regulation, to foster program diversity.[1124] Further, the record in this proceeding does not contain evidence that affiliates air programming that is more diverse than programming aired by network-owned stations. Therefore, we cannot affirm our earlier determination regarding program diversity, and we do not find that the cap is necessary to foster program diversity.

c. Localism

538 *Introduction* The Commission's decision in the *1984 Multiple Ownership Report and Order* did not address whether the national TV ownership rule advances its goal of localism.[1125] In the *1998 Biennial Review Report*, however, the Commission did address its localism goal, declining to modify the national TV ownership restriction in part because affiliates "play a valuable counterbalancing role" to network programming decisions by exercising their independent programming discretion regarding what programs best serve the needs and interests of their local communities [1126] In *Fox Television,* the court stated that, although the Commission had failed to present evidence that the cap in fact promoted localism, localism was a legitimate basis for imposing a national ownership cap [1127]

539. Based on our analysis of the extensive record in this proceeding, we conclude that a national television ownership limit is necessary to promote localism on broadcast television. The evidence suggests, however, that the current 35% cap is not needed the protect localism, and may in fact be hindering public benefits that are expected to follow from an increase in the cap. We conclude that a national cap of 45% fairly balances the competing public interest values affected by this rule We recognize that our decision to retain a national ownership cap is contrary to our conclusion in 1984. We reach this different conclusion principally because we find that a cap is necessary to protect localism by preserving a balance of power between networks and affiliates, a policy objective that was not considered in the 1984 decision. In this section, we detail the localism analysis Thereafter, we discuss our modified rule.

[1122] Cox briefly discusses program, source and outlet diversity, but it does not provide evidentiary support for its arguments. Cox Comments at 65-66 CPD fails to explain how repealing the 35% cap would diminish program and source diversity in prime time programming *See* CPD Comments at 3-6

[1123] *1998 Biennial Review Report,* 15 FCC Rcd at 11075 ¶ 30.

[1124] *See* Policy Goals, *supra* Section III.

[1125] *See 1984 Multiple Ownership Report and Order.*

[1126] *1998 Biennial Review Report,* 15 FCC Rcd at 11074-75 ¶ 30.

[1127] "[T]he public interest has historically embraced diversity (as well as localism) . . . and nothing in § 202(h) signals a departure from that historic scope." *Fox Television,* 280 F.3d at 1042.

(i) Whether a National Cap Promotes Localism

540 In this section we examine the effect of a national television cap on the economic incentives for locally responsive programming by television stations We also consider evidence that a national cap results in behavior by network-affiliated stations that is responsive to the needs and tastes of a station's local community.[1128]

(a) Economic Incentives for Localism

541. NAB/NASA contends that the current national cap is needed to preserve affiliates' bargaining power with their networks.[1129] NAB/NASA explains that limiting the national audience that networks can reach through their owned stations promotes a balance of power between networks and their affiliates NAB/NASA also claims that the cap is necessary to counteract the networks' strong financial incentive to promote the widest distribution across the nation of network programming irrespective of the tastes of one or more particular local cities. The widest possible distribution of programming, according to NAB/NASA, increases viewership of network programming, which maximizes network advertising revenues According to NAB/NASA, maximum national exposure of programming also improves the likelihood that the program owner will realize additional revenues in the program syndication market. NAB/NASA contends that as broadcast networks have ownership stakes in a larger percentage of their prime time programming, their incentive to create programs with syndication value -- and their incentive to stifle local preemption -- increases.[1130]

542 NAB/NASA argues that the incentive of independently-owned affiliates, in contrast to network-owned stations, is to make programming decisions that are more closely aligned with the needs and tastes of their communities of license.[1131] A network derives its income from the programming that the network produces (and the syndication revenue the programs might generate) as well as from its local stations. A local station maximizes its income by providing programming desired by its local community irrespective of national programming preferences. Therefore, the programming interests are not always the same

(b) Evidence of Localism by Affiliates

543 NAB/NASA contends that the national cap is needed to preserve a body of network affiliates not owned by the network that can influence network programming so that it is more suited to

[1128] Cox argues that allowing networks to significantly expand their station ownership will increase the networks' ability to pressure cable operators, and erode the cable operators' bargaining position, during retransmission consent negotiations. Cox Comments at 41-47, Letter from Alexander V. Netchvolodoff, Senior Vice President of Public Policy, Cox Enterprises, Inc., to Marlene H Dortch, Secretary, FCC (Feb. 3, 2003) at 1-2. *See also* American Cable Association Petition for Inquiry into Retransmission Consent Practices (filed Oct. 1, 2002); Children Now Comments at 13-15. Fox responds that the negotiations are not affected by the number of stations owned by a network, but by each party's market-by-market evaluation of whether the agreement is beneficial. Letter from John C. Quale, Counsel for Fox, to Marlene H Dortch, Secretary, FCC (April 21, 2003) ("Fox April 21, 2003 Ex Parte") at 2. Cox's arguments are outside the scope of our biennial review.

[1129] NAB/NASA Comments at 9.

[1130] *Id* at 33

[1131] *Id* at 10

the tastes and needs of the affiliates' communities.[1132] In support of this argument, NAB/NASA submitted several examples of the influence independent affiliates can have on network programming:

- When NBC aired a special edition of *Fear Factor*, featuring Playboy bunnies, during halftime of the Superbowl (airing on Fox), affiliates objected to the network promos, which ran during all hours of the day, and included tag lines such as "who needs football when we've got bunnies?"

- NAB/NASA states that when NBC began a trial program to accept liquor advertisements, so many affiliates opted out of airing the ads due to local concerns that NBC dropped the program.

- CBS had scheduled the *Victoria's Secret Fashion Show* for 8 p.m. The affiliates objected to the early showing and urged that the program be moved to the 10 p.m. time slot. In response, CBS moved the show to 9 P M., although some affiliates nonetheless preempted the show as having inappropriate content for their service areas.

- Promotional ads for NBC's *Dog Eat Dog* included shots of nude contestants promoting the program's challenges such as "strip football" and "strip golf." When affiliates objected to the explicitness of the promos and their airing at all times of day, NBC agreed to eliminate strip stunts from future episodes.

- *NYPD Blue* was originally designed to include more nudity and graphic language than is currently aired, but after ABC affiliates objected, the amount of nudity and graphic language in the show was reduced. Even so, a number of affiliates initially refused to carry the show.

- Affiliates expressed concerns about the violent and mature content of the series *Kingpin,* which concerns the life of a drug lord. In response, NBC agreed to allow affiliates to review episodes in advance to ensure the content is appropriate for their local communities.

- In 2002, CBS worked with affiliates to reformat its morning news program, *The Early Show.* One key issue of affiliate concern was whether they would be permitted to provide local news content during the two-hour time block used by the program, as they had with CBS' prior show, *CBS This Morning.* Although some local affiliates are permitted to use the blended format with *The Early Show,* CBS has refused to permit other affiliates to move to the blended local-network news program format.[1133]

- NBC affiliates objected to NBC's intention to broadcast the 2002 Olympic Games live, which would have preempted the evening news on the west coast. After initially resisting the requests of the west coast affiliates to air a delayed broadcast during prime time, the network conducted a viewer survey. Results of the survey, however, substantiated the affiliates' assertion that west coast viewers preferred to watch the games during prime time, and the networks complied.[1134]

[1132] *Id* at 27.

[1133] *Id* at 25-26, 29-30

[1134] *Id* at 30-31.

- NBC affiliates initially objected to NBC's decision to require live broadcasting of the XFL games. On the west coast, games substantially preempted both the affiliates' early evening local news and the national network news. In other parts of the country, overruns of the game preempted the late night local news. When affiliates raised similar concerns about Arena Football, claiming that overruns would preempt the 6 p.m. local newscasts on the east coast, the network agreed to work with the sports league to ensure the games do not run over [1135]

- KYTV in Springfield, Missouri, preempted a January 6, 2003 episode of NBC's *Fear Factor,* which airs at 7 p.m. Central Time, that involved contestants eating horse rectums because it found the material inappropriate for its community.[1136]

544 Separate from this "collective negotiation" type of localism, parties also submitted evidence regarding the frequency of station-by-station preemptions for affiliates versus network-owned stations.[1137] Preemptions are instances in which local stations, whether they are owned and operated by networks or independently owned but affiliated with these networks, choose to air a program other than the program the network distributes to the station. The networks submitted data comparing prime time preemption rates of network-owned stations versus affiliates for 2001. That data showed that affiliates preempted an average of 9 5 hours of prime time programming per year compared with 6.8 hours per year for network-owned stations.[1138] The networks claim that this difference is inconsequential and does not

[1135] *Id* at 30

[1136] NAB/NASA Reply Comments at 16-17

[1137] Affiliates described numerous examples of individual station preemptions of network programming. Some of these examples follow WRAZ-TV in Raleigh, North Carolina, chose to stop airing *Temptation Island* after Fox revealed that one of the participating couples had a child because "WRAZ will not support a program that could potentially break up the parents of a young child" *Id* at 17. WFAA-TV in Dallas did not carry the entire first season of *NYPD Blue* because it found the material and language inappropriate for programming scheduled to air at 9 p m in that community *Id* KNDX in Bismarck, N D., refused to clear the Fox network's broadcast of the movie *Scream,* which is targeted to young viewers, because of its graphic and disturbing portrayal of teenage murders. *Id.* WFAA-TV, an ABC affiliate in Dallas, was denied permission to preempt *Monday Night Football's* half-time show on November 12, 2001 to cover an American Airlines plane crash American Airlines is based in Dallas. According to NAB/NASA, ABC permitted two O&Os to preempt the same half-time show to air news covering the same crash *Id* at 37-38 CBS did not permit WTSP-TV in Tampa Bay to air a debate between Jeb Bush and Bill McBride during the Florida gubernatorial debate because the affiliate would have preempted the season premiere of *48 Hours* WTSP-TV was a cosponsor of the debate. *Id* at 38 A Raleigh North Carolina Fox affiliate refused to air *Who Wants to Marry a Multimillionaire?* because it "felt it was demeaning to women and made a mockery of the institution of marriage" *Id* at 38-39. WANE-TV, the Fort Wayne, Indiana CBS affiliate, sought to preempt network programming to air a half-hour, early morning local news program geared toward the agricultural community Although this was initially denied, CBS ultimately relented and granted permission *Id.* at 39 In this *Report and Order*, we use the terms "network-owned" stations and "O&O" (*i e* owned and operated) stations interchangeably.

[1138] Fox Comments, Economic Study G provides data showing: (1) both O&Os and affiliates preempt less than one percent of prime-time programming (in 2001), (2) the four networks' 57 O&O stations preempted an average of 6.8 hours per year per station compared to an average of 9.5 hours per year per station for 651 non-owned affiliates; and (3) on average, O&O stations preempt roughly the same amount of programming – 0.8 hours per station per year – as affiliates for news, political and public affairs programming. Fox Comments, Economic Study G justify retention of a national ownership cap [1139] Affiliates assert that even this hand-picked data by networks confirms that affiliates preempt more than network-owned stations and that a national cap is needed to protect localism.[1140]

545. Affiliates seek to explain low preemption rates by arguing that networks have increasingly restricted preemption through their network-affiliate contracts. Cox argues that the networks have been exacting greater concessions from their affiliates, including demands to decrease the number of preemptions.[1141] Affiliates complain that they are subject to preemption caps involving financial penalties or loss of affiliation if they exceed the number of network-authorized preemptions,[1142] while affiliates' local programs are often "preempted" by network overruns (*e.g.*, network sports overrunning local news).[1143] For example, Cox submits information gathered from its television stations in which the stations document their conflicts with the networks over network programming and local tastes and station preemptions.[1144] According to NAB/NASA, Fox allows only two preemptions per year, and NBC allows only five hours of prime-time preemptions per year. Affiliates that exceed their allowable preemption "basket" may be subject to financial penalties or even loss of affiliation.[1145] Thus, while a majority of affiliates did not exceed their permitted preemptions,[1146] affiliates argue that there are good reasons for that result. In addition, affiliates note that they often maintain a "cushion" of unused preemption time in case it is needed, requiring them to exercise discretion in "spending" their preemption time during the year to avoid contractual financial penalties associated with excessive preemption.[1147]

546. *Discussion.* We find that a national television ownership cap is necessary to promote localism The evidence before us demonstrates both that network affiliates have economic incentives more oriented towards localism than do network-owned stations, and that affiliates act on those incentives in ways that result in networks delivering programming more responsive to their local communities (in the judgment of the affiliate) than they otherwise would. In order for affiliates to continue to serve local

[1139] *Id*

[1140] NAB/NASA Reply Comments at 32-35.

[1141] Cox Comments at 34-38

[1142] NAB/NASA Comments at 39-43

[1143] Cox Comments at 34-41, NAB/NASA Comments at 43-45.

[1144] Cox Comments at Appendix C-1

[1145] NAB/NASA Comments at 39-41. NASA filed a Petition for Inquiry into Network Practices on March 8, 2001, and a Motion for Declaratory Ruling on June 22, 2001. NASA claims, among other things, that contractual language contained in network affiliation agreements violates the "letter and spirit" of Section 310(d) of the Communications Act of 1934, the right to reject rule and the time option rule (47 C.F.R. § 73.658(d) & (e)) We are addressing the merits of this petition separately from this proceeding.

[1146] Disney Comments at 4-7 Disney Exhibit G presents the number of available and used preemptions for ABC affiliates based on negotiated baskets of preemptions. According to Disney, during all of 2001, affiliates used only 56% of the permissible preemptions available to them and out of 189 affiliates, 150 did not exceed their baskets

[1147] NAB/NASA Reply Comments at 36-37.

community tastes and needs in this way, a national cap is needed to preserve a body of independently-owned affiliates The two ways in which affiliates can promote localism are by collective negotiation to influence the programming that the networks provide and by preemption by an individual station owner to provide programming better suited to its community.

547 The record shows that network-owned stations and affiliates have different economic incentives regarding the programming aired by local stations. We agree with NAB/NASA's study by Schwartz and Vincent that affiliates have an economic incentive to target their local audience by offering programs suited to local tastes [1148] In so doing, affiliates have an incentive to tailor their programming schedule to meet local preferences.[1149] Localism is fostered by the affiliates' efforts to promote their own economic interest of maximizing the value of their stations by offering programming that local viewers will prefer to watch, even if the programming replaces the network's nationally scheduled programming

548. The 2001 preemption data comparing network and affiliate preemption rates also supports retention of a national cap. The record shows that in 2001, affiliates preempted 9.5 hours per year of prime time programming versus 6.8 hours per year for network-owned stations. This data bolsters our conclusion that affiliates act on their economic incentives to preempt network programming with measurably greater frequency than do network-owned stations. Although we agree with the networks that the total number of hours preempted by both types of station owners in this comparison is relatively small, these data are for the prime time viewing period, when the vast majority of television viewing occurs. In our view, the practical effect of prime time preemption is far greater than that of preemption during other dayparts.

549. We cannot agree with Fox that network-owned stations provide the same localism value that independently-owned affiliates do. Fox argues that networks listen to the management of network-owned stations as well as to the management of affiliates It claims that managers of O&Os participate during the networks' program development process and provide more credible input than the management of affiliate stations.[1150] Fox also asserts that affiliates have an "inherent economic conflict" with the network regarding the distribution of profits, have no influence in the development of new programs, and learn of the new programs at the same time as do advertisers.[1151]

550. We agree with Fox that affiliates have an inherent economic conflict with networks. However, we believe that affiliates' economic incentives actually help explain why affiliates regularly raise programming concerns with networks and why affiliates preempt more network programming, on average, than do network-owned stations. In our view, affiliates' economic incentives to maximize local viewership works to promote localism.

551. In addition, Fox's claim of minimal affiliate influence over programming is overcome by the significant evidence submitted by NAB/NASA that affiliates regularly raise programming concerns with networks and frequently succeed in altering network programming in ways that protect local interests These numerous instances of the collective influence brought to bear by affiliates on network

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[1148] NAB/NASA Comments, Schwartz/Vincent Paper

[1149] Cox Comments at 47-52, 60-62.

[1150] Fox April 21, 2003 Ex Parte at 2.

[1151] *Id*

programming decisions represents a powerful force for the protection of local viewing interests. They represent empirical evidence that affiliates collectively serve as an important counterweight to network programming decisions by influencing networks to deliver programming responsive to local tastes.

552 In sum, we believe that this affiliate/network dynamic is beneficial to viewers and should be preserved We conclude that eliminating the cap altogether would shift the balance of power with respect to programming decisions toward the national broadcast networks in a way that would disserve our localism policy [1152]

(ii) Appropriate Level of the Cap

553 In the preceding section, we found that a national television ownership cap continues to be necessary to promote localism because the record demonstrates that affiliates affect network programming in ways that respond to viewer preferences in affiliates' local communities. In this section, we examine the specific effects of the current 35% cap and whether this particular level achieves our localism objectives

554. *Preemptions* Affiliates argue that the networks have limited their ability to preempt network programming in order to provide programming more geared to local needs and interests, and that these limits have become more formidable as the networks have extended their ownership of stations.[1153] Affiliates argue that an increase in the national cap reduces affiliates' ability to resist network pressure not to preempt The affiliates point to a decline in affiliate preemptions following the 1996 increase in the cap from 25% to 35%. The affiliates' submission indicates that, with respect to all dayparts (as opposed to prime time-only), affiliates preempted, on average, 48 hours per year between 1991 to 1995 and 36 hours per year between 1996 to 2001.[1154] It also shows that, in the year 1995, the year before the cap was increased to 35%, there were, on average, 46 hours of programming preempted, but by the year 2001 the average had declined to 33 hours.

555. The networks offer two responses to the affiliates' data. First, the networks submit preemption data that, according to the networks, shows that the 35% cap has no effect on bargaining power between networks and affiliates. The networks contend that if higher levels of network station ownership actually increased networks' leverage over their affiliates, we would expect affiliates of the largest network station owners to preempt less (because of their diminished bargaining power) than affiliates of a network that had significantly less station ownership. The networks data shows that affiliates of the largest network-owners (CBS and Fox, at 39% and 38% national reach respectively) preempt to an equal or greater extent than do affiliates of ABC, with a national reach of 23%.[1155] The

[1152] Our concerns are substantiated by statements from consumer groups asserting that large companies are less responsive to consumer complaints *See* Catherine Yang, *The FCC's Loner is No Longer So Lonely*, BUS. WK, (Mar. 24, 2003) at 78

[1153] NAB/NASA Comments at 31

[1154] *Id* at 16

[1155] Fox April 21, 2003 Ex Parte at 8-9.

networks assert that this data proves that the 35% cap has no effect on bargaining leverage between networks and affiliates [1156]

556 Second, the networks argue that affiliate preemptions often are not for programming that is of greater public interest, but for syndicated programs.[1157] The data Disney submits suggests that more affiliates preempted ABC programming in favor of syndicated programming than for local specials.[1158] In addition, Disney states that very few half hours of affiliate prime-time preemptions were for news, political, or public affairs programming.[1159] Disney's data, however, is countered by a NAB/NASA survey of affiliated stations, in which respondents reported preempting network programming for: local breaking news (83% of respondents); local news (71% of respondents); local emergencies (70% of respondents), local political programming (74% of respondents); local sports (75% of respondents); religious programming (47% of respondents), "other" programming (*e.g.*, parades, telethons, syndicated programming, movies) (34% of respondents).[1160]

557. Apart from contractual restrictions, a majority of affiliates responding to a NAB/NASA survey -- 68% -- report that they have "experienced pressure from [their] network to not preempt programming."[1161] UCC provides several instances of increased network resistance when affiliates attempted to air programs deemed to be of greater local interest than the network programming. For example, it cites to the experience of Belo's ABC affiliate in Dallas, the headquarters of American Airlines, which failed to get the network's permission to preempt the November 12, 2001, Monday Night

[1156] *Id.* In a motion filed May 28, 2003, NAB/NASA asked the Commission to disregard certain portions of network submissions concerning preemption and local news quantity because the networks have not provided the data underlying those submissions Alternatively, NAB/NASA asked the Commission to infer that the underlying data would not favor the networks' positions on preemption and news quantity of O&O versus affiliate stations. The portions of the network filings the Commission is asked to disregard include, *inter alia*, EI Study G and Disney Exhibit G, relating to preemptions, and EI Study H, relating to local news quantity. Fox opposed the motion on May 29, 2003 We will afford the record evidence the appropriate weight in light of all circumstances, including the extent to which we believe the underlying data is necessary to make an informed decision about the showing

[1157] Disney Comments at Exhibit H shows, among other things, that during the first quarter of 2002, affiliates preempted ABC programming more for syndicated programming than for local specials

[1158] Disney Comments at 4-7 Disney Exhibit J shows, among other things, that during the first quarter of 2002, affiliates preempted ABC programming more for syndicated programming (201 half-hours) than for local specials (188 half-hours)

[1159] *Id* The remaining prime-time preemptions were for sports, telethons, syndicated and local entertainment, paid programming, and paid religious specials Disney Exhibit J shows that, for all of 2001, of 3,694 half-hours of primetime preemptions, 291 were for news, political, or public affairs programming; 574 half-hours were for telethons; 864 half-hours were for entertainment; 105 were for news; 171 were for public affairs; and 1,561 were for sports related shows.

[1160] NAB/NASA Comments at 17-18, Table 2, Attachment 2.

[1161] *Id* at 17 NAB/NASA sent the survey to 422 ABC, CBS, and NBC affiliated stations asking them to report on their experience with networks regarding preemption It reports receiving 201 "usable" responses.

Football halftime show for local news updates on the American Airlines jet crash in New York that morning [1162]

558. *Discussion* Although we concluded in the prior section that a national cap is needed to balance power between networks and affiliates, the record suggests that maintaining the cap at 35% is not necessary to preserve the balance of bargaining power between networks and affiliates. In reaching this conclusion, we rely principally on the evidence showing that the largest network station owners possess no greater bargaining power – as measured by prime time preemptions – than the smallest network station owner We find this evidence persuasive because it directly compares the extent to which different levels of network ownership of stations actually affect the level of preemption by those networks' affiliates. Implicit in this analysis is an assumption that that data, although not a perfect proxy, is a reliable indicator of relative bargaining power between networks and affiliates. Preemption of network programming by an affiliate has negative consequences to the network, and networks by all accounts seek to avoid preemption by affiliates.[1163] So the ability of an affiliate to preempt in the face of networks' incentives to *prevent* preemption appears to be a reasonable measure of relative bargaining power between networks and affiliates.

559 We are not persuaded by the affiliates' argument that the 35% cap is needed to protect localism because the most recent national cap increase resulted in fewer affiliate preemptions. The principal deficiency in this argument is that it does not control for other plausible causes of the decline in affiliate preemptions. Although NAB/NASA suggests that the 1996 increase in the national cap reduced affiliates' bargaining power, NAB/NASA itself identifies other factors occurring in the same timeframe as the national cap increase that it claims have further eroded affiliate bargaining power. NAB/NASA asserts that the Commission's repeal of its financial interest and syndication rules in the early 1990s gave networks an additional financial incentive (in addition to their incentive to avoid preemption to maximize advertising rates) to discourage affiliate preemption. NAB/NASA contends that vertical integration, including program ownership and syndication by broadcast networks and the trend toward "repurposing" of network programming on affiliated non-broadcast channels have helped increase the networks' leverage over affiliates [1164] To the extent these additional factors actually enhance network bargaining leverage as NAB/NASA contends, they undercut NAB/NASA's argument that it was specifically the 1996 increase in the national cap that caused affiliates to reduce their preemption of network programming.

560 A more accurate assessment of the impact of the 1996 national cap increase on network-affiliate bargaining leverage could be made if affiliate preemption rates from 1991 through 2001 could be compared to the preemption rates of network-owned stations during that same period. If preemption rates

[1162] UCC Comments at 51-52 (citing Michele Greppi, *The Insider A(BC's) Tale of Too-Different Cities,* ELECTRONIC MEDIA (Nov. 19, 2001) at 8). Among its other examples, CBS pressured a Florida affiliate into running the season premier of "48 Hours" instead of the state's gubernatorial debate. UCC Comments at 52 (citing Wes Allison, *Local PBS Affiliate Will Air Debate,* ST. PETERSBURG TIMES (Sept 25, 2002) at 1B.). Also, NBC resisted attempts by affiliates to preempt a baseball game to air a presidential debate during the 2000 campaign. UCC Comments at 52 (citing Neil Hickey, *Unshackling Big Media,* COL. J REV. (July/Aug. 2001) at 30)

[1163] *See, e g* , NAB/NASA Comments at 17 (stating that 68% of affiliates responding to a survey claimed that they have "experienced pressure from [their] network not to preempt programming")

[1164] *Id* at 31-39

on network-owned stations were similar to affiliate preemption rates over that same period, we might have a more certain -- and completely different -- explanation for the decline. Networks might well have persuaded us that the uniform decline in preemptions by O&Os and affiliates was caused by some plausible reason unrelated to the change in the national cap. On the other hand, if the data had shown preemption rates on network-owned stations remaining steady while affiliate preemptions declined sharply after 1996, then the affiliates' explanation for the decline (*i.e.* increase in the national cap) would carry more weight than we give it here.

561 The foregoing analysis of preemption data excludes consideration of the content of the programming substituted by the local station for the network programming. Other than our interest in promoting market structures that encourage local news production, we seek to avoid resting broadcast ownership policies on subjective judgments about the public policy value of different types of locally-substituted programming. We agree with NAB/NASA that it is enough, for purposes of assessing stations' responsiveness to local communities, that they preempted network programming. The judgment of when to preempt and what to substitute are uniquely within the judgment -- and responsibility -- of the station.

562. Thus, we reaffirm our conclusion, in the *1998 Biennial Review Report*, that independently-owned affiliates play a valuable role by "counterbalancing" the networks' economic incentive to broadcast their own programming "because they have the right . . to air instead" programming more responsive to local concerns.[1165] But, the evidence suggests that the current limit of 35% is overly restrictive and that the cap may safely be raised and the benefits of wider network station ownership achieved (discussed below) without disturbing either this balance or affiliates' ability to preempt network programming.

(iii) Other Effects of the Current 35% Cap

563 In the preceding sections, we examined two measures of localism -- collective affiliate influence on network programming and specific preemption levels by affiliates versus network-owned stations. In this section we consider a third measure -- the effect of the national cap on the quantity and quality of local news and public affairs programming We examine this area because local news and public affairs programming can play an important role in citizen participation in local and state government affairs. Thus we seek market structures among broadcasters that encourage stations to produce local news and public affairs programming and thereby contribute to an informed citizenry.

564. In its 1984 decision, the Commission compared the quality and diversity of programming by stations owned by group owners – both network and non-network owners – with that of singly owned stations It concluded that there was no evidence that group owners provided less or lower quality news and public affairs programming than single owners.[1166] The *Fox* court criticized the Commission for failing to explain in the *1998 Biennial Review Report* why it departed from this conclusion. With the decline in the number of individually owned stations, an increase has occurred in the number of stations sharing common ownership. The Commission sought in this biennial review to understand whether the national TV ownership rule, by preserving a class of affiliates, affects localism by comparing the local

[1165] *1998 Biennial Review Report*, 15 FCC Rcd at 11075 ¶ 30 In its remand, the *Fox Television* court did not dispute the Commission's view in the 1998 decision, but said the Commission failed to show whether it had received evidence substantiating its 1998 conclusion or repudiating its 1984 conclusion *Fox Television*, 280 F.3d at 1043.

[1166] *1984 Multiple Ownership Report and Order*, 100 F C C 2d at 32-34 ¶¶ 44-51.

news and public affairs programming of network owned and operated stations to that of non-network owned affiliates. We discuss the evidence and our conclusions below.

565. *Quantity of local news and public affairs programming.* In the *Notice,* the Commission requested evidence regarding any clear relationship between the ownership of stations and the quantity and quality of local news and public affairs produced by those stations.[1167] A study conducted by Commission staff concluded that network-owned stations produced more local news and public affairs programming than affiliates and received local news excellence awards more frequently than affiliates.[1168] Responding to that study, NAB/NASA submitted a study indicating that many of the results of MOWG Study No 7 changed when data pertaining to stations belonging to Fox were not used.[1169] The final study, submitted by Dr. Michael Baumann of Economists Inc., demonstrates that no defensible reason exists for deleting the Fox station data [1170] This final, comprehensive study provides analysis purporting to demonstrate that network-owned stations, on average, produce more local news than do affiliates across all-sized markets, with an even greater difference in the amount of news offered by network-owned stations in smaller markets.[1171]

566 The results of MOWG Study No. 7 show that network-owned stations air 23% more local news and public affairs programming per week than affiliates (22.8 hours versus 18.5 hours).[1172] In response to MOWG Study No. 7, NAB/NASA conducted a study that revealed no statistically significant difference between hours of local news aired by affiliates and O&O stations.[1173] Unlike MOWG Study No 7, the NAB/NASA study included data on ABC, NBC and CBS, but did not include data on Fox Television [1174] Disney argues that there is no policy-based rationale for excluding Fox stations.[1175] Using the NAB/NASA data, but accounting for all four of the networks, Dr Baumann determined that network-

[1167] *Notice,* 17 FCC Rcd at 18550 ¶ 148

[1168] MOWG Study No 7 at 3-6.

[1169] NAB/NASA Early Submission (Dec 9, 2002)

[1170] Letter from Susan L Fox, Vice President, Government Relations, Disney, to Marlene Dortch, Secretary, FCC (Feb 13, 2003) ("Disney Feb 13, 2003 Ex Parte") In response to a criticism of MOWG Study No 7, which could also apply to Fox Economic Study H, Economists Inc conducted a slightly modified analysis filed as part of "Economic Comments on Media Ownership Issues"), which was attached as an exhibit to the Fox Reply *See also* Fox Comments, Economic Study H

[1171] Disney Feb. 13, 2003 Ex Parte at Attachment.

[1172] Only MOWG Study No 7 examined newspaper-owned affiliates separately from the other affiliates. It showed that, on average, newspaper-owned affiliates provided more hours per week of local news and public affairs (about 22 hours) than did the other affiliates (approximately 15 hours) The study also showed that network O&Os provided the most local news of all (almost 23 hours)

[1173] NAB/NASA Early Submission (Dec. 9, 2002).

[1174] *Id* On May 5, 2003, NAB/NASA submitted another letter reiterating its argument. The submission, however, provided no new data or additional information. *See* Letter from Alan Frank, Chair, NASA, to Michael K Powell, Chairman, FCC (May 5, 2003) ("NASA May 5, 2003 Ex Parte").

[1175] Disney Feb 13, 2003 Ex Parte, Attachment at 7, n.6.

owned stations on average provide more local news -- about 4.2 hours per week -- than do affiliates in all markets In markets outside the top 25 markets, network-owned stations provide almost eight more hours of local news each week than affiliates do. Inside the top 25 markets, Disney agrees with the NAB/NASA study results that the difference between network-owned stations and affiliates was not statistically significant.[1176]

567. In Dr Baumann's study, a third data set was used in analyzing local news and public affairs programming on network-owned and affiliate stations.[1177] Results, however, were similar to the first two studies network-owned stations produce about 6.4 more hours per week of local news than affiliates in all markets tested. As with the modified NAB/NASA data, in markets outside the top 25 markets, network-owned stations provide about 9 hours additional local news each week. This study agrees with the NAB/NASA results that the difference between network-owned stations and affiliate stations in news provided was not statistically significant in markets inside the top 25 markets.[1178]

568. *Local News Quality*. Although the Commission does not regulate programming quality, it has attempted to strengthen the ability of local stations to serve their communities through news and public affairs programming. In the *Notice*, we sought to understand whether the national TV ownership rule may have the effect of increasing or decreasing the quantity and/or quality of local news and public affairs programming.[1179] Studies discussing programming quality were submitted in the record.

569. MOWG Study No. 7, for example, finds that network O&O stations win more awards for local news programming than non-O&O affiliates. In evaluating the quality of local news programming, the authors used three measures. (1) ratings received for local evening news; (2) awards from the Radio and Television News Directors Association (RTNDA); and (3) the local television recipients of the Silver Baton of the A I Dupont Awards. The ratings of network-owned stations and affiliates were virtually identical during the period tested However, with respect to the receipt of RTNDA awards for news excellence, network-owned stations received those awards at a rate of 126% of the national average and affiliates received them at 96% of the national average. The study found, with respect to the DuPont awards, network-owned stations received awards at 337% of the national average, while affiliates received awards at 77% of the national average.

570 The results of a second study, however, indicate that quality differences between network-owned stations and affiliates are virtually nonexistent. In comparing the record of network-owned stations and affiliates' news operations, a study by Economists Inc. on behalf of the networks focused on the RTNDA awards, one of the awards used in MOWG Study No. 7.[1180] It reasoned that, because a larger number of RTNDA awards are given out each year, they are more likely to offer a better measure of news quality than the DuPont awards. The study examined the RTNDA awards from two perspectives, first

[1176] *Id* at 8-9, NAB/NASA Early Submission (Dec 9, 2002).

[1177] The measure of weekly minutes of local news, public and current affairs programming was provided by TV Guide for a week in May 2002. The set of explanatory variables includes market rank, whether a station was an O&O or not, and other market characteristics. Disney Feb 13, 2003 Ex Parte, Attachment at 10.

[1178] *Id.* at 12, NAB/NASA Early Submission (Dec. 9, 2002).

[1179] *Notice*, 17 FCC Rcd at 18550 ¶ 148

[1180] Response of Fox to NAB/NASA Early Submission (Dec. 19, 2002) at 5 and App. 1

analyzing the awards bestowed in the top 10 markets, and then the top 50 markets. The study concludes that, in either setting, "there is no discernible difference between network-owned stations and affiliates with respect to RTNDA awards."[1181] Neither this study nor MOWG Study No. 7 suggests that affiliates provide higher quality local news and public affairs programming than network-owned stations. Thus, the studies provide evidence that a national limit of 35% is not necessary to preserve a class of affiliates in order to maintain high quality local news and public programming.

571 UCC argues that the number of awards received by stations is not a reliable measure of quality because the awards are not equally available to both network stations and affiliates. It argues that stations must apply for awards and pay entry fees to be considered.[1182] Moreover, it argues, networks generally have promotion and publicity departments that handle award entries, while local stations do not.[1183] While we agree with UCC that factors unrelated to quality programming can affect the number of awards received, there is no evidence that these factors had any measurable effect on the conclusion that network-owned stations' news programming is at least equivalent in quality to that of affiliates.

572 A third study finds that smaller station groups tend to produce higher quality newscasts than larger groups.[1184] In the PEJ Study, affiliates generally had higher quality scores than network-owned stations. Sixteen percent of affiliate stations earned "A's" in programming quality versus 11% of network-owned stations[1185] According to PEJ's survey results, affiliates generally demonstrate somewhat more enterprise, cite more sources, tend to be more local, and are more likely to air stories that affect the community Network-owned stations, on the other hand, are more likely to air national stories with no local connection, although they tend to air more points of view and score better in finding the larger implications of a story.[1186] The study also shows that only 22% of stations owned by the 25 largest group owners earned "A" grades for quality, compared with 48% of midsize and small groups. It acknowledges, however, that ratings for local news programming are growing more rapidly at larger group-owned stations than at smaller ones[1187] Results of the PEJ Study suggest that being a network-owned station does not "improve the kind of local news that citizens see."[1188]

[1181] *Id* at App. 1 at 10-11. This study used the same data as MOWG Study No 7.

[1182] UCC Comments at 55 (citing Radio-Television News Directors Association and Foundation, *Awards and Scholarships 2003 RTNDA Edward R Murrow Awards*, at www.rtnda org/asfi/awards/murrow.shtml; The Graduate School of Journalism at Columbia University, *Alfred I. DuPont Columbia University Awards*, www.jrn columbia.edu/events/dupont/entryform pdf).

[1183] *Id* (citing E-Mail from Jonnet S. Abeles, Director, Alfred I DuPont Awards, Columbia School of Journalism, Nov 7, 2002).

[1184] PEJ Study, supra note 769.

[1185] *Id* at 4.

[1186] *Id.* at 9

[1187] *Id* at 3.

[1188] *Id* at 8

573 A critique prepared by Economists Inc. asserts that PEJ's principal findings are statistically insignificant[1189] In addition, they contend the study relies on subjective measures of newscast quality, and does not account for other factors affecting news quality, such as geographic differences. In the critique, Economists Inc. states that PEJ has advised that it will not make underlying data available for analysis and review within the time frame of this proceeding; thus only limited information is available for use in determining the validity of PEJ's results.[1190] PEJ responds that the point of its survey was to identify patterns and trends in news quality It asserts that it was not trying to prove a particular theory of cause and effect with its research, and states it has no financial stake in the outcome[1191] Whether or not the PEJ Study is unbiased, its results appear statistically insignificant, the underlying data have not been made available, and therefore it cannot be considered reliable or convincing evidence

574 The affiliates argue, however, that localism cannot be limited to local news and public affairs; rather, it is a rich mix of programming, and that the Commission itself has previously identified other elements, such as opportunities for local self-expression, development and use of local talent, weather and market reports, and sports and entertainment programming as necessary and desirable in serving the broadcast needs and interests of local communities.[1192] As we said in the *Notice*, stations may fulfill their obligation to serve the needs and interests of their communities by presenting local news and public affairs programming and by selecting other programming based on the particular needs and interests of the station's community.[1193] Thus, we acknowledge that other kinds of programming are important in serving local needs. However, we must rely on the data in the record, which focuses on two aspects of localism – program selection decisions by affiliates (preemption/collective negotiation) and the quality and quantity of local news and public affairs programming. From the data, we conclude that network-owned stations provide local news and public affairs programming that is at least equal, and may be superior, to that of affiliates.

575. *Discussion* We conclude that the national cap is not necessary to encourage local stations to air local news and public affairs programming The record actually suggests that the national cap diminishes localism by restraining the most effective purveyors of local news from using their resources in additional markets. The studies before us show that network-owned stations air, on average, more local news and public affairs programming than affiliates overall.[1194] MOWG Study No. 7 found that network-owned stations aired 4.3 hours more local news per week than did affiliates[1195] The Baumann study concluded that the differential was 6.4 hours per week.[1196] The principal objection to the findings

[1189] Economists Inc , "*The Project for Excellence in Journalism's PEJ Study of Ownership and Quality of Newscasts A Critique*" (Mar. 13, 2003)

[1190] *Id* at 2.

[1191] PEJ Study, *supra* note 769

[1192] NAB/NASA Reply Comments at 4 (citing FCC Form 303, Attachment A of 1960 Report and Statement of Policy re Commission En Banc Programming Inquiry (July 29, 1960)).

[1193] *Notice*, 17 FCC Rcd at 18526 ¶ 70.

[1194] MOWG Study No. 7.

[1195] *Id*

[1196] Disney Feb 13, 2003 Ex Parte

of these two studies was NAB/NASA's criticism that exclusion of the Fox stations from those two studies would nullify the differential between the two groups of stations.[1197] We agree with Disney that no valid reason exists for excluding the Fox stations.

576. The record also shows that local news on network-owned stations appears to be of higher quality than news on affiliate stations. MOWG Study No. 7 found that network-owned stations received local news excellence awards at a significantly higher rate than did affiliates. For the DuPont awards, networks received 337% of the national average compared with 77% for affiliates. For the RTNDA awards, networks received 126% to affiliates' 96%.[1198] We disagree with commenters relying on the PEJ study to show that smaller group owners tend to produce higher quality local news. We agree with the networks that the findings of the PEJ are statistically insignificant. In other words, according to widely-accepted scientific standards, there is an unacceptably large risk that the PEJ's findings are attributable to random noise in the data. The PEJ Study reports the differences in percentages of newscasts that received a particular grade, but fails to provide any statistical testing on these results. The networks conducted these statistical tests and determined that the differences in news quality were not large enough to conclude that the probability of a newscast getting a particular grade was dependent on the ownership group that aired the newscast.

577 In sum, the record shows that the national cap is not necessary to promote high quality, or relatively larger amounts of, local news programming. The record suggests the opposite – that the current cap prevents networks from acquiring more stations and providing enhanced local news operations.

3. Modification of the National Television Ownership Rule

578 We have concluded that an audience reach cap of 35% is not necessary to promote diversity or competition in any relevant market We are persuaded, however, that a national cap at some level is needed to promote localism by preserving the balance of power between networks and affiliates. We found that affiliates' incentives are more attuned to their local communities than are those of networks, which seek to assure that the largest audiences possible are watching their programming at the same time. We conclude from the record that preserving a balance of power between a network and its affiliates promotes localism, and accordingly, we will continue to restrict the national audience reach of station owners.

579 Given the benefits to innovation discussed above that derive from having a number of separately-owned station groups, we believe the national ownership cap should continue to apply to all station owners, including those that are not networks. The record shows that there have been a number of instances where having a variety of owners has led to innovative programming formats and technical advances, and we believe that applying the national ownership cap to all station owners will continue to spur innovation, which we believe will be particularly valuable in transitioning to digital television. In addition, applying the cap to all station owners adheres to our longstanding policy of refusing to

[1197] NAB/NASA Comments at 46.

[1198] A score of 100% for a station group would indicate that the stations in that group won precisely the number of awards that would be expected given the number of stations in that group relative to the total number of stations in the U S